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IN THE

Supreme Court of the United States

October Term 1951

No. 179

OSTERMAN & HUTNER, GOLDMAN, SACHS & CO., GRAHAM-NEWMAN CORPORATION, NEWMAN & GRAHAM, and ABRAHAM & CO.,

Petitioners,

—against—

GUARANTY TRUST COMPANY OF NEW YORK, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, JULIUS KLORFEIN, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company, dated February 1, 1924, CITY BANK FARMERS TRUST COMPANY, as Trustee under The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY, and HAROLD S. BAIRD,

Respondents.

BRIEF OF RESPONDENT GUARANTY TRUST COMPANY OF NEW YORK, AS TRUSTEE UNDER THE FIRST CONSOLIDATED MORTGAGE DEED OF THE RIO GRANDE WESTERN RAILWAY COMPANY DATED APRIL 1, 1899, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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INDEX

PAGE

Decisions and Opinions Below 1

Statement as to Jurisdiction 2

Statement of the Case 3

POINT I

The Bankruptcy Act is not involved and therefore no Federal question is presented 4

POINT II

Petitioners never became parties to the action and accordingly have no standing in this Court 11

CONCLUSION 13

CASES CITED:

Brown v. Gerdes, 321 U. S. 178 8

Insurance Group v. Denver &c. Ry., 329 U. S. 607 3

Leiman v. Guttman, 297 N. Y. 201, aff. 336 U. S. 1 7

Matter of Brown (Gerdes), 290 N. Y. 468 8

R. F. C. v. Denver &c. Ry., 328 U. S. 495 3

OTHER AUTHORITIES:

254 ICC 349 9

New York Civil Practice Act
Section 193-b 11

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No. 179

Osterman & Hutner, Goldman, Sachs & Co., Graham-Newman Corporation, Newman & Graham, and Abraham & Co.,

Petitioners,

—against—

Guaranty Trust Company of New York, as Trustee under the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company, dated April 1, 1899, Julius Klorfein, The Chase National Bank of the City of New York, as Trustee under the Refunding and Improvement Mortgage of The Denver and Rio Grande Western Railroad Company, dated February 1, 1924, City Bank Farmers Trust Company, as Trustee under The Denver and Rio Grande Western Railroad Company's General Mortgage, dated February 1, 1924, The Denver and Rio Grande Western Railroad Company, and Harold S. Baird,

Respondents.

BRIEF OF RESPONDENT GUARANTY TRUST COMPANY OF NEW YORK, AS TRUSTEE UNDER THE FIRST CONSOLIDATED MORTGAGE DEED OF THE RIO GRANDE WESTERN RAILWAY COMPANY DATED APRIL 1, 1899, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Decisions and Opinions Below

There were two opinions handed down by the Trial Court. On September 14, 1950 the Trial Court handed down an opinion in connection with the making of an

order granting allowances (R. 179), and then on October 5, 1950, it wrote a second opinion (R. 185). The occasion for the second opinion was the denial of a motion made by the present petitioners for leave to intervene in the action (R. 18 *et seq.*). That motion was based solely on petitioners' theory that the state court lacked jurisdiction to grant allowances payable out of the proceeds of sale; it did not question the reasonableness of the amounts allowed. The second opinion dealt both with petitioners' alleged right to intervene and also at some length with the question of the state court's jurisdiction to grant allowances.

The order granting allowances was unanimously affirmed without opinion by the New York Appellate Division, First Department (R. 197-199). A motion for leave to appeal was denied by the Court of Appeals (R. 203-204).

The order denying petitioners' motion for leave to intervene was likewise unanimously affirmed by the Appellate Division with a modification which related only to the hearing of that appeal (R. 200-202).

Statement as to Jurisdiction

Petitioners claim that the order granting allowances which they now seek to have reviewed violates their rights under the Bankruptcy Act and also under that section of the Constitution which empowers the Congress to establish uniform laws on the subject of bankruptcies (Petition, pp. 2-3, and Appendix thereto).

In behalf of respondent, Guaranty Trust Company of New York, as trustee (hereinafter called Guaranty), it is suggested that there is no jurisdiction because:

1. The Bankruptcy Act is not involved and therefore no Federal question is presented.

2. Petitioners never became parties to the action and accordingly have no standing in this Court.

Statement of the Case

The action was brought by Guaranty to foreclose a collateral pledge of the capital stock of Utah Fuel Company. The pledge had been made in 1901 by the then owners, Spencer Trask & Co., as accommodation collateral security for the payment of the principal and interest of the bonds (hereinafter called Consols), secured by the First Consolidated Mortgage Deed of The Rio Grande Western Railway Company. The extent of the pledge was $6,000,000. Possession of the certificates passed to Guaranty.

Subsequently, and in connection with a reorganization of the successor railway, The Denver Rio Grande and Western (hereinafter called Denver), subordinate liens on the same stock were created first in favor of the Refunding and Improvement Bonds (hereinafter called Refundings), represented by The Chase National Bank of the City of New York (hereinafter called Chase), as trustee, and lastly in favor of the General Mortgage Bonds, represented by the City Bank Farmers Trust Company (hereinafter called City Bank), as trustee. The equity of redemption was transferred in due course to Western Pacific Railroad Corporation and Missouri Pacific Railroad Company.

The records of this Court show that the Denver was reorganized under the Bankruptcy Act, and that on two occasions this Court considered and approved the Denver Plan. *R. F. C.* v. *Denver &c. Ry.*, 328 U. S. 495 (hereinafter referred to as the first Denver case) and *Insurance Group* v. *Denver &c. Ry.*, 329 U. S. 607 (hereinafter referred to as the second Denver case).

As the equity of redemption in the Utah Fuel stock did not belong to the Denver, the Bankruptcy Court had no jurisdiction over it, and accordingly Guaranty began the present action in the New York State court which did have

jurisdiction. Under the final judgment, the stock was sold at foreclosure and brought $6,800,000.

Petitioners do not attack the jurisdiction of the state court in the foreclosure proceedings, or the propriety of its final judgment of foreclosure and sale of the Utah Fuel stock. They assert merely that while the state court had full jurisdiction over the foreclosure and sale, it nevertheless had no jurisdiction whatever to make any allowances to the Trustees or their counsel or to any of the other parties in the foreclosure proceedings, and that in respect to all such allowances the parties should have made application to the Bankruptcy Court in Denver, which had nothing to do with the foreclosure action and which never had any jurisdiction over the subject matter of that action.

POINT I

The Bankruptcy Act is not involved and therefore no Federal question is presented.

This action is not ancillary to the Denver reorganization, but is a wholly independent plenary action brought in a New York state court by a New York pledgee to foreclose a lien created by a New York contract on property which formed no part of the bankrupt estate. It is therefore misleading to say (petition p. 4) that parties to the reorganization proceedings instituted the action. It was instituted, as the complaint shows (R. 78), by the Guaranty as pledgee in the state court because of the want of jurisdiction in the Bankruptcy Court. Of course, if the Bankruptcy Court had had jurisdiction of the stock it would have disposed of it in the reorganization. That would have been its duty.

As, however, the New York court alone had jurisdiction of the stock, necessarily it alone had jurisdiction of

the proceeds which replaced the stock after the foreclosure sale. The Bankruptcy Court which for lack of jurisdiction could not deal with the stock, could not assume or acquire jurisdiction of the proceeds after they had come into the hands of the New York court.

The matter was carefully analyzed in the second opinion of Mr. Justice Pecora (R. 185-188). With reference to the jurisdiction of the state court, he says:

> "The fundamental consideration which the moving parties overlook is the fact that this court is dealing with an action and property over which the federal courts never had any jurisdiction. The reorganization proceedings were concerned only with the property of the debtor railroad; and concededly the Utah Fuel Company stock never was any part of the debtor's estate. If it had been, it would have been disposed of in the reorganization proceedings. As that stock was not any part of the property of the debtor, the federal courts have heretofore recognized that they had no jurisdiction to foreclose the liens thereon and to make disposition thereof. The federal courts therefore left to this court the right and duty to foreclose the liens on that stock, and to do whatever else was necessary and incidental to such a foreclosure; to the end that this property (not within the federal jurisdiction) might be effectually and completely dealt with. Thus because the federal reorganization court clearly had no jurisdiction, and this court on the contrary clearly did have jurisdiction, a suit was duly instituted in this court in order to secure a full and complete adjudication of the rights of all the parties thereto.
>
> "Now what had to be done to accomplish such an adjudication? Of course the liens had to be adjudged and defined; their true amounts had to be ascertained,

and the deficiencies thereunder had to be duly fixed; a sale of the pledged stock had to be made; the costs and expenses had to be paid, and distribution of the remaining proceeds had to be effected. No lesser exertion of power would obviously be consonant with common sense, with due justice to the parties, and with a proper regard for the right and duty of the court in the exercise of its conceded jurisdiction over the res in question and the parties before it.

"An inevitable part of this power was, therefore, the authority to decide and determine upon the allowances to be made to the parties and their counsel; not only was there authority for such allowance in the mortgages under foreclosure, but also in the inherent power of the court in such an equity action. 'Plainly the foundation for the historic practice of granting reimbursement for the cost of litigation other than the conventional taxable costs is part of the original authority of the chancellor to do equity in a particular situation' (Sprague v. Ticonic Bank, 307 U. S., 161, 166).

"Equally clearly those costs and allowances had to be fixed before anything could be paid over to the bondholders entitled to receive the remaining proceeds. Hence it is manifest that the jurisdiction in this case extended, and had to extend, to the making of the allowances in question. It could not well be otherwise. Not only was this court the best advised of any tribunal concerning what should be allowed; but if, as asserted by the moving parties, the matter of such allowances lay wholly and exclusively within the power of the Colorado federal court, then it is clear that no genuinely final determination could be made in this action until after such federal court had fixed those

allowances. And what would happen if, as is conceivable, the federal court saw fit never to take such action, or saw fit inordinately to delay it? The courts of this state would, in such event, be powerless to remedy such a situation; and this cause might then eventuate in an utter futility, or justice therein be indefinitely and helplessly postponed. Such a consequence only makes more evident the clear necessity for the possession by this court of plenary jurisdiction over the res and the parties in this action; and such jurisdiction, I am convinced that it has, should have, and must exercise.

"I see nothing in the Colorado decree which compels me to any different result. It cannot, in my opinion, be construed in one breath to renounce jurisdiction over the Utah Fuel stock in favor of this court, and in the next breath, nevertheless, seek to withhold from this court a necessary part of such jurisdiction. Particularly may no such construction be indulged in, since it is clear that the federal court had, and could have, no power over that stock, as it was no part of the property of the debtor."

To read the Consummation Order (R. 58), as petitioners do, as an attempt by the District Court to control the New York court in the conduct of foreclosing a lien on property not belonging to the Debtor is obviously to misread the order. The jurisdiction of the District Court was exclusive as far as it went, but it was limited to the Debtor and its property. The very cases cited by petitioners rest on this principle.

Leiman v. *Guttman,* 297 N. Y. 201, affirmed 336 U. S. 1, was an action in the State court on a contract which provided for counsel fees. The services for which the action was brought had been rendered in reorganization proceed-

ings brought under the Bankruptcy Act in the Federal courts. The facts are almost the reverse of ours. There the proceeding in which the services were rendered was a bankruptcy matter, here it was not; there the services were rendered in a Federal court, here they were not; there the Federal Judge was personally familiar with the nature and extent of the services, here it was the State Judge who had these advantages.

Matter of Brown (*Gerdes*), 290 N. Y. 468, affirmed *sub nom. Brown* v. *Gerdes,* 321 U. S. 178, concerned services rendered in an action in a state court by counsel representing the bankrupt estate. Any allowances that were made would have to be paid by the bankrupt estate. For that reason it was held that the Federal court had exclusive jurisdiction.

On page 181 of the opinion this Court says:

> "Sec. 77B, like §77 of the Bankruptcy Act, had as one of its purposes the establishment of more effective control over reorganization fees and expenses * * * in recognition of the effect which a depletion of the cash resources of the estate may have on both the fairness and feasibility of the plan of reorganization."

In that sentence, we submit, is to be found the real basis for exclusive Federal jurisdiction of fees for services rendered in state courts, where such exclusive Federal jurisdiction exists. If the Debtor were asked to pay, the Federal court alone could fix allowances. The principle involved, however, has no bearing on fees earned in a state court foreclosure action which were payable from a source which was wholly outside the Debtor's estate, and of which the state court had exclusive jurisdiction.

Nor is it correct to argue that payment of expenses and compensation out of the proceeds in any way infringes on

the Plan, for, as the stock did not belong to the Debtor, the Plan (254 ICC 349, 398-399) could not and did not purport to award it to bondholders; the Plan recognized that the plaintiff, as trustee, had a lien on it which was not enforceable in the Federal court.

The Plan gave bondholders only new railroad securities. It then left the stock, over which the Bankruptcy Court never had any jurisdiction, in the possession of the trustee which had it, to be distributed by that trustee under the power given by the mortgage or foreclosed in a court which had the necessary jurisdiction.

The District Court could not "reserve", a jurisdiction it never had; of course it did not purport to. It had jurisdiction over the Debtor. It alone could have required the Debtor to pay, but it did not rule that a state court having exclusive jurisdiction over stock that did not belong to the Debtor was not free to foreclose a lien on it, or to pay proper expenses and allowances out of the proceeds of sale.

The intention of the District Court clearly appears from the fact that in the Consummation Order (R. 58) it provided that (R. 63-64) the First Consolidated Mortgage, the Refunding and Improvement Mortgage and the General Mortgage should be satisfied, cancelled, and released, "provided, however, that this order neither affects nor purports to affect:

> "(A) The lien of the above-mentioned First Consolidated Mortgage of The Rio Grande Western Railway Company on the 100,000 shares of capital stock of the Utah Fuel Company, heretofore deposited and pledged with the trustee under said mortgage under a Pledge Agreement dated May 23, 1901, or the rights of the trustee as pledgee thereof" (R. 64).

Similar provisions are made (R. 65) with reference to the continuing liens of the Refunding and of the General mortgages on the same stock.

The lien of the First Consolidated Mortgage, so reserved expressly included a lien for services (R. 124).

The lien of the mortgage is applicable not only to the railroad securities pledged thereunder, but also to the collateral. This is established by the pledge agreement, which provides (R. 94):

> "The said stock shall be held by the said Morton Trust Company [corporate predecessor of Guaranty] as such Trustee as security for the payment of the principal and interest of the bonds of the said Rio Grande Western Railway Company secured by said first consolidated mortgage and in all respects subject to the terms and conditions of said mortgage with reference to the railroad securities pledged thereunder * * *"

In other words, the stock was pledged subject to all the provisions of the mortgage (R. 94); the mortgage contained a provision giving the trustee a lien on pledged securities for the costs and expenses of the sale including reasonable compensation to the trustee and to its agents, attorneys, and counsel (R. 92); and this provision of the mortgage was by the Consummation Order expressly preserved (R. 64) although in all other respects the mortgage was declared null and void, satisfied, cancelled, and released (R. 64).

POINT II

Petitioners never became parties to the action and accordingly have no standing in this Court.

In this action, Chase as trustee represented all the holders of the Refundings, including the petitioners. Petitioners were content with this representation until August 9, 1950 when they moved to intervene in the action (R. 18-19). The controlling New York statute is Section 193-b of the Civil Practice Act. By that statute, intervention can be had only "upon timely application". Petitioners' motion was not made until after the question which they sought to raise had been adjudicated.

The final judgment, made September 23, 1949 (R. 135) contained a provision (R. 161) which determined the right to have allowances paid out of the proceeds of sale. Before petitioners moved, this judgment had been unanimously affirmed by the Appellate Division (277 App. Div. 767). Subsequently it was also affirmed by the Court of Appeals (302 N. Y. 658). Under New York law, as determined by the New York court in this case (R. 185, at 188) petitioners' application was not timely.

As it happened, however, petitioners waited until the situation had been even further crystallized before they attempted to intervene. In due course various parties moved for allowances. It was not until after these motions were granted, and specific amounts had been awarded to parties and counsel, and the decision had been printed in the New York Law Journal, that petitioners moved. Their motion papers contain the statement (R. 29):

> "The opinion of Mr. Justice Pecora on the application for allowances appears in the New York Law Journal of this date and is incorporated by reference herein."

It is therefore inaccurate to say (petition p. 6):

> "The state court judge, over the objection of these petitioners, made an order granting to respondent-trustees and their counsel and to counsel for respondent bondholder-intervenors allowances aggregating $266,427 * * *."

October 5, 1950 their motion to intervene was denied (R. 15-17).

February 27, 1951, the order was unanimously affirmed by the Appellate Division (R. 200-202) without opinion, and with a modification (R. 202) which, an inspection shows, related only to the hearing before the Appellate Division.

Petitioners have failed to include in the Record prepared by them the papers showing that on April 4, 1951, they moved in the Appellate Division for leave to appeal to the Court of Appeals from the affirmance of the order denying their motion to intervene and that the Appellate Division, without opinion, denied their motion.

Who can intervene in a New York case under the New York statute and in what circumstances are clearly questions for New York courts. In the present instance, the Trial Court and the Appellate Division have both held that these petitioners may not intervene. Their motion was denied (R. 15). Yet the petition (p. 1) casually refers to the petitioners as "intervenors below".

The force of the New York decisions is not lessened because the Trial Court and the Appellate Division graciously listened to petitioners on the merits, and pointed out that on the merits, too, under New York law, petitioners must fail.

CONCLUSION

The petition should be denied.

Dated, New York, August 1, 1951.

Respectfully submitted,

THEODORE KIENDL
Attorney for Respondent
Guaranty Trust Company
of New York, as Trustee.